No. 80-84

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

ANDERSON BROS. FORD AND FORD MOTOR CREDIT COMPANY,

Petitioners,

v.

OLGA VALENCIA AND MIGUEL GONZALEZ,

Respondents.

On A Writ Of Certiorari To The United States Court of Appeals For The Seventh Circuit

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BRIEF OF THE UAW LEGAL SERVICES PLAN AS *AMICUS CURIAE*

MATTHEW J. MASON
RICHARD SCUPI *
621 New Center Building
7430 Second Avenue
Detroit, MI 48202
(313) 872-4600

Attorneys for Amicus Curiae

* Attorney of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

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BRIEF OF THE UAW LEGAL SERVICES PLAN AS *AMICUS CURIAE*

The UAW Legal Services Plan respectfully submits this Brief as *amicus curiae* in support of the Respondents, filed upon the written consent of all parties in accordance with Rule 36.2 of the Rules of this Court.

INTEREST OF *AMICUS CURIAE*

The UAW Legal Services Plan ("Plan") is a national prepaid legal services program for employees and retirees of the Chrysler Corporation. Staff offices are located in Michigan, Indiana, Missouri, Ohio, Delaware, New York

and Illinois. Legal services in areas not covered by staff offices are provided by a combination of referrals to private attorneys, contracts with private attorneys and insurance plans.

Since opening in November, 1978 the Plan has handled over 43,000 cases, almost 11,000 of which were categorized as consumer cases. A significant number of the consumer cases involve consumer credit transactions subject to the Truth in Lending Act.

Virtually every installment sales contract entered into by the Plan's clients includes the financing of insurance premiums either for property damage coverage, credit life insurance or credit disability insurance. These premiums involve hundreds of dollars in each contract. The disclosure of the security interest in unearned premiums is important to participants of the Plan and, presumably, to consumers in general.

SUMMARY OF ARGUMENT

The Truth in Lending Act ("TILA" or "Act") and Regulation Z mandate that all "security interests" must be disclosed on the front of a retail installment contract together with other required TILA disclosures. In the contract in question, Petitioner has a right to apply any unearned insurance premiums to the outstanding debt but has failed to include that right as part of its TILA disclosures.

The issue is whether the interest in unearned insurance premiums is a "security interest" under the Act and Regulation Z. If so, the failure to disclose the interest as such violated the Act.

Petitioner does not seriously dispute that the right to unearned insurance premiums is a "security interest". The decisions of each of the circuit courts of appeal have found the right to unearned insurance premiums is a

security interest. The Federal Reserve Board has consistently viewed the right to unearned insurance premiums as a security interest under the Act. Even the proposed Official Staff Interpretation of the Board, on which action has been deferred pending this Court's decision, recognizes that the right to unearned insurance premiums is a security interest albeit an "incidental interest" under the Act. This consistent view of the Federal Reserve Board is entitled to deference.

Assuming *arguendo* that the Act and Regulation Z do not require disclosure of all security interests but only "substantial" security interests and only when disclosure would not confuse consumers, the security interest here would still have to be disclosed.

The right to the unearned insurance premiums is a substantial economic right. It is the experience of *Amicus* that the amount of unearned insurance premiums in question can be as great as $1,600.00 in a typical automobile retail installment contract. Nationwide, in 1978, over 83,000,000 people were covered by credit life insurance, one of the types of insurance reflected in the $1,600.00 figure. The total amount of insurance written was over $163,000,000,000.00.

The right to unearned premiums is also of practical significance. Absent the creditor's security interest, the consumer could cancel the insurance and apply the refunded premiums as necessary. The unearned premiums could be available to stop a mortgage foreclosure or even a default on the existing loan. For creditors the practical significance arises from the ease with which the unearned premiums are obtained in the event of default. The creditor can obtain the money without litigation, notice to the debtor, or the cumbersome method of repossession and resale as in the case of other collateral. In light of these economic and practical considerations, the

right to unearned insurance premiums is a substantial right. To characterize it in any other way ignores the reality of consumer credit transactions.

Nor would the disclosure of that security interest have to detract from the consumer's understanding of the typical installment contract. Less disclosure is not necessarily better disclosure. The concept often referred to as "information overload" does not mean that more disclosure is bad any more than it means that less disclosure is necessarily good. The ability to understand information actually increases as the information load increases, until an optimum level is reached.

Rather "readibility", or the method of presentation, is the more important factor in a consumer's understanding of retail installment contracts. Studies have shown that consumers better understand contracts drafted for "readability" than those containing fewer disclosures yet drafted in a typical "legal" style. "Readability" is within the control of the drafter. Thus creditors' complaints that disclosure of their interest in unearned premiums would frustrate the purpose of the Act assumes that creditors will use needlessly complicated and wordy forms. *Clearer disclosure is required, not less disclosure.*

In considering this issue this Court must look to the plain meaning of TILA and Regulation Z. The Third, Fifth, Seventh and Eighth Circuits each present well reasoned and logical arguments consistent with the purpose of the existing Truth in Lending law. In light of those decisions this Court should find that the right to unearned insurance premiums is a substantial interest which must be disclosed under TILA and affirm the decision of the Seventh Circuit Court of Appeals now before this Court.

ARGUMENT

I. THE RIGHT TO UNEARNED INSURANCE PREMIUMS IS A SECURITY INTEREST AND MUST THEREFORE BE DISCLOSED AS SUCH

A. Any Security Interest Must Be Disclosed Under The Act And Regulation Z

The Act requires "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit and a clear identification of the property to which the security interest relates." 15 U.S.C. § 1638(a)(10). Regulation Z defines a "security interest" as "any interest in property which secures payment or performance of an obligation." 12 C.F.R. § 226.2(gg) (1980).

There are no exceptions to, or limitations on, the requirement to disclose all security interests. Where the Act and implementing regulation use the term "any," the attempt to have that language read to mean "certain" is misdirected advocacy. If the right to unearned insurance premiums is a security interest as defined by the Act and Regulation Z, then Petitioner's failure to disclose it as required violated the Act.

B. The Circuits Have Found And Petitioner Concedes That The Right To Unearned Insurance Premiums Is a A Security Interest

All five circuit courts of appeal to consider the issue have found that the right to unearned insurance premiums is a security interest for the purposes of TILA.[1]

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[1] *James* v. *Ford Motor Credit Co.*, —— F.2d —— (10th Cir. 1980); *Murphy* v. *Ford Motor Credit Co.*, 629 F.2d 556, 558, 559 (8th Cir. 1980); *Valencia* v. *Anderson Bros. Ford*, 617 F.2d 1278, 1281, 1286 (7th Cir. 1980); *Souife* v. *First National Bank of Com-*

Four of the five circuits have held that the failure to disclose a security interest in unearned insurance premiums as part of the required Truth in Lending disclosures constituted a violation of the Act.[2]

In *Valencia* v. *Anderson Bros. Ford*, 617 F.2d 1278, 1284 (7th Cir. 1980), the Court saw that the starting point of any analysis had to be the definition of a "security interest" in Regulation Z. That definition provided "a straightforward, two step approach to classification of interests for disclosure purposes". *Id.* at 1284. *One, the right conferred must be an interest in property; two, the right must secure payment or performance of an obligation.*

Petitioner conceded in *Valencia* that the right to unearned premiums is an interest in property, albeit incidental. *Id.* at 1285-86. The court had only to read the contract to find that the assigned premiums secured performance or payment of the obligation to maintain insurance coverage. The creditor can use the unearned premiums to purchase replacement insurance. The premiums can also be applied to reduce the outstanding obligation at the creditor's discretion. *Id.* at 1286 n.10. Thus, *Valencia* concluded that the right to unearned premiums "is by definition a security interest for TILA purposes, 12

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merce, 628 F.2d 480, 481, 482-83 (5th Cir. 1980); *Edmundson* v. *Allen-Russell Ford, Inc.*, 577 F.2d 291, 293, 294 (5th Cir. 1978), *cert. denied*, 441 U.S. 951 (1979) and *Gennuso* v. *Commercial Bank & Trust Co.*, 544 F.2d 437, 440 (3d Cir. 1977). The *James* opinion is reprinted as addendum 27 to Petitioner's Brief.

[2] *Murphy*, 629 F.2d at 560; *Valencia*, 617 F.2d at 1286; *Souife*, 628 F.2d at 483, *Edmundson*, 577 F.2d at 294 and *Gennuso*, 544 F.2d at 440, n.2. Even *James*, the sole circuit court opinion holding that disclosure is not required, admits that the contractual right to unearned premiums creates a security interest under TILA. *James* cites the 1980 amendments to the Act for the proposition the security interest in unearned premiums is not the *type of security interest* that need be disclosed. *James*, Addendum to Petitioner's Brief at 33.

C.F.R. § 226.2(gg), and as such must be disclosed." *Id.* at 1286.

Petitioner still refers to the assignment provision as an "interest in property." Petitioner continues to admit that the right to premiums secures performance of the obligation to maintain insurance, insulating lenders from the risk of damage to the collateral and nonpayment of the underlying debt in the event the collateral is damaged.[3] Petitioner's Brief at 4-5, 9.

C. The Only Position Of The Federal Reserve Board Entitled To Any Deference Is Its Consistent View That The Right To Unearned Insurance Premiums Is A Security Interest Under The Act

Despite the variety of pronouncements in differing forms from the Federal Reserve Board,[4] the Board has consistently maintained that the right to unearned insurance premiums is a security interest.

The first Board pronouncement was an Unofficial Staff Interpretation, FRB Public Position Letter No. 377 issued on July 22, 1970, which addressed an analogous interest in insurance premiums.[5] A creditor proposed to

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[3] "The purpose of an assignment of unearned premiums in physical damage coverage is to assure the continued existence of the insurance on the vehicle during the life of the loan. Without the protection of such an assignment, debtors could cancel such insurance on financed vehicles, thereby exposing lenders to the risk of uninsured collateral". Petitioner's Brief at 4-5.

[4] Typically, the Board issues official staff interpretations upon which parties may rely under 15 U.S.C. § 1640(f) as a good faith defense and unofficial staff interpretations which "have no special status under Sec. 1640(f)." *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 567, n. 10 (1980).

[5] FRB Public Position Letter No. 377, [1969-1977 Transfer Binder] Cons. Credit Guide (CCH) ¶ 30,555 (July 22, 1970).

pay for accidental death and dismemberment insurance policies from the proceeds of loans. If the consumer defaulted, the creditor would cancel the policy and apply premium refunds to the unpaid balance of the loan.[6] Letter No. 377 required disclosure of "the loan company's ownership of the policy[7] as a type of security interest under Section 226.8(b)(5)."[8]

The next significant pronouncement was also an Unofficial Staff Interpretation, FRB Public Information Letter No. 1263, issued on November 23, 1977.[9] No. 1263 expresses the staff's opinion that "assignment of re-

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[6] The life insurance policy in No. 377 was a single premium lifetime accidental death and dismemberment policy. That insurance policy is reminiscent of the currently fashionable credit life insurance policy. While this case only involves property risk insurance, the vast majority of automobile retail installment contracts include credit life insurance. *See* text accompanying n. 16, *infra*. *See also Souife* v. *First National Bank of Commerce*, 528 F.2d at 481 (Credit life insurance and property damage insurance purchased).

[7] Petitioner's interest in the property damage insurance is much more substantial than the situation raised in No. 377. Petitioner's interest includes proceeds from the policy, unearned premiums and the right to cancel, to purchase substitute insurance or to settle any claim, applying the proceeds as it sees fit. *Valencia* v. *Anderson Bros. Ford*, 617 F.2d at 1231.

[8] Regulation Z, § 226.8(b)(5) (1980) states in pertinent part: (b) Disclosures in sale and nonsale credit. In any transaction subject to this section, the following items, as applicable, shall be disclosed:

* * * *

(5) A description or identification of the type of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit, and a clear identification of the property to which the security interest relates.

[9] FRB Public Information Letter No. 1263, [1974-1977 Transfer Binder] Cons. Credit Guide (CCH) ¶ 31,736 (November 23, 1977).

turned and unearned premiums may transfer to the creditor such an [security] interest." But No. 1263 did not specifically mandate disclosure of the right to unearned insurance premiums and insurance proceeds, instead deferring to the *courts* to interpret state substantive law and federal disclosure requirements.

Then on May 5, 1980 the Federal Reserve Board issued its first complete revision of Regulation Z designed to implement the 1980 amendments to the Truth in Lending Act. Despite the changes made by the Simplification and Reform Act,[10] the revised Regulation Z defined "security interest" to mean "an interest in property that secures performance of a consumer credit or lease obligation and that is recognized by and enforceable under state law." [11] There was no exception for unearned insurance premiums.

On September 18, 1980, the Board proposed FC-0173, the only Official Staff Interpretation on this issue, subsequently deferred pending consideration of this case.[12] That interpretation *deletes all references to state law* and reiterates that "a technical reading of the security interest definition might cover a creditor's interest in insurance proceeds and unearned premiums". The Board then proposed to except disclosure of a security interest in unearned premiums as an "incidental interest" not of the type meant to be covered by Regulation Z, § 226.8 (b) (5).

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[10] Those amendments were enacted as Title V of the Depository Institutions Deregulation and Monetary Control Act, 96-221, 94 Stat. 132. The amendments are known as the Truth in Lending Simplification and Reform Act.

[11] Revised Truth in Lending Regulation Z, § 226.2(bb), CCH Cons. Credit Guide Report No. 304 (May 5, 1980).

[12] Proposed Official Staff Interpretation, FC-0173, September 18, 1980. On December 15, 1980, the Board of Governors of the Federal Reserve System deferred final action on that interpretation.

In December, 1980, the Board issued its second complete revision of Regulation Z. It changed the definition of security interest to include:

> an interest in property that secures performance of a consumer credit or lease obligation and that is recognized by and enforceable under *state and federal law.*

Revised Truth in Lending Regulation Z, § 226.2 CCH Cons. Credit Guide Report No. 319 (December 4, 1980) (emphasis added). The Board still recognized that the interest in unearned insurance premiums was a security interest but excepted it, as in the proposed Official Staff Interpretation, FC-0173, as an "incidental interest."

However, the "incidental interest" doctrine of FC-0173 is not entitled to any significant weight by this Court. This is not the same situation as in *Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555 (1980). There this Court had before it an *adopted official* staff interpretation of the Federal Reserve Board, as well as several unofficial staff interpretations consistent with the official view.

The absence of an official staff interpretation in this case creates an entirely different situation. Under Regulation Z, 12 C.F.R. § 226.1(d), official staff interpretations are released only after interested parties have had an opportunity to comment upon the interpretation. Courts giving deference to such official interpretations know that the Board has had an opportunity to consider the positions of both creditors and consumers. Unofficial staff interpretations are responses to questions posed by individual creditors or consumers requesting an opinion on a specific set of facts, with no opportunity for comments by other interested parties. The proposed Official Staff Interpretation FC-0173 was withdrawn by the Board after comments were received but before any consideration was given to the comments. To give deference to a proposed but withdrawn staff interpretation would be inappropriate.

Thus these several positions by the Board are certainly consistent in viewing the right to unearned premiums as a security interest under the Act. None of the later pronouncements invoking the incidental interest doctrine have been officially adopted and should have no bearing on this case.

II. EVEN IF THE ACT AND REGULATION Z REQUIRED THAT ONLY SUBSTANTIAL SECURITY INTERESTS NEED BE DISCLOSED AND ONLY WHEN THIS COULD BE DONE WITHOUT CONFUSING CONSUMERS, THE RIGHT TO UNEARNED INSURANCE PREMIUMS WOULD HAVE TO BE DISCLOSED

If we assume with Petitioner that the Act and Regulation Z do not require that *any* security interest be disclosed, then we confront the issues of whether the security interest here is "incidental" and whether its disclosure would confuse, rather than aid, consumers in understanding retail installment contracts.

A. The Right To Unearned Insurance Premiums Is A Substantial Interest

Individual retail installment contracts for automobiles commonly include financing for credit life insurance and credit disability insurance as well as property damage insurance. As a result of this multi-risk coverage, the right to unearned premiums can average hundreds of dollars in each transaction and as such constitutes a substantial economic interest. In the Detroit, Michigan area the average insurance premium for a standard no-fault insurance policy with comprehensive and collision coverage ranges from $477 to $893 per year.[13] The additional

[13] This is based upon a standard no-fault insurance policy with $50.00 deductible comprehensive, $100.00 deductible collision on a mid-priced ($6000-8500) 1980 Chevrolet Impala automobile. The $477.00 figure is for a senior citizen defined as over the age of 65.

coverage for credit life and health and accident insurance averages $775.25.[14] Thus in the retail installment sales contract where all three types of insurance are purchased and financed under the contract, the first year premium ranges from $1,252.25 to $1,628.25 on a midpriced car.[15]

Viewed in the aggregate, this means that vast amounts of money are invested in insurance premiums financed as part of retail installment contracts. Where physical damage insurance is required under the contract, as here, the coverage rate approximates 100%. Similar rates are approached for credit life insurance. As early as 1969, credit life insurance was written in connection with 75% of all consumer credit transactions. American Council of Life Insurance, *Life Insurance Fact Book* 35 (1969). More current estimates indicate that it is not unusual for a creditor to achieve a 100% "penetration rate" in the sale of credit life insurance.[16] Board of Governors of the

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The $893.00 figure is for a single male under 25. Other classifications by age and sex fall between those two figures. State of Michigan, Department of Licensing and Regulation, Insurance Bureau Internal Memoranda. These estimates are based upon rate filings by insurers in September, 1980.

[14] This figure for credit life and credit disability was calculated from tables and formulas supplied by the Michigan Insurance Bureau, Department of Licensing and Regulation. For our example, we assumed a mid-sized automobile with a purchase price of $6,500.00. The credit disability coverage provided is one with a fourteen day waiting period with retroactive benefits and covering pre-existing medical conditions. The credit life insurance in this situation is $258.42 and credit disability costs the consumer $516.83. A 48 month contract was assumed.

[15] These statistics correspond to those in the reported cases. In *Valencia*, 617 F.2d at 1281 the cost of physical damage coverage was $442.00 on a $1,340.00 used automobile. In *Souife*, 628 F.2d at 480, the consumer purchased property insurance and credit life insurance.

[16] Professor Jonathan Landers in *Determining the Finance Charge Under the Truth in Lending Act*, 1 Am. Bar Foundation Research J. 45, 115 (1977) states: "[I]ndeed in some states it is

Federal Reserve System, *Annual Report To Congress On Truth In Lending For The Year 1976* 34 (1977). The total number of persons insured in 1978 under credit life insurance policies *alone* was 83,725,000. The total amount of insurance was $163,681,000,000. American Council of Life Insurance, *Life Insurance Fact Book* 34 (1979).

The ease with which the unearned premiums can be obtained and used by the creditor also enhances the economic value of the right to unearned premiums. The creditor need only make a demand upon the insurance company. There is no requirement of a judgment. There is no expense or uncertainty involved as there is in a repossession and resale of the collateral. Once obtained:

> The creditor is expressly granted "sole discretion" to apply returned premiums toward payment of the indebtedness; this discretion may, of course, be exercised in the event of default. The creditor may also apply the returned premiums toward substitute insurance on the property, thereby securing the debtor's contractual obligation to obtain and maintain insurance on the vehicle.

Edmundson, 577 F.2d at 294. The creditor is not required to consult the debtor first. Nor must any statutory lien procedures be followed. Essentially the contract gives the creditor the right to use $1200-$1600 of the debtor's money as it sees fit.

In addition to being substantial in the sense of economic value, the right to unearned premiums is also a substantial right when consumer credit transactions are analyzed at a practical level. Ordinarily hundreds of dollars in unearned premiums are available to consumers if they choose to cancel their insurance coverage. Knowl-

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the profit from insurance that keeps many small loan companies in business". (citations omitted) *See also* J. Sheffey, *Credit Life and Disability Insurance Disclosures Under Truth in Lending: The Triumph of Form Over Substance*, 8 Fla. St. U.L. Rev. 463 (1980).

edge that the money from unearned insurance premiums is not available for their use can affect decisions about cancellation of the insurance policy, prepayment of the obligation or default.[17] For example, absent the security interest, a debtor facing a mortgage foreclosure, could cancel the policy. The debtor could then use the rebated premium to make overdue mortgage payments. Or the debtor might elect to apply part of the proceeds to the underlying debt and part to another obligation.

However, having granted the creditor a security interest in the unearned premiums, the debtor no longer has the right to those premiums. Public comments on record with the Federal Reserve Board suggest that consumers are surprised and angry to learn after executing such a contract that the creditor has retained an interest in these monies. Federal Reserve Board, Comments Re Proposed Official Staff Interpretation FC-0173, Public Comment No. 53 (1980).

Also the frequency upon which the contract term is relied is an indication of its importance. It is the experience of *Amicus* that creditors, upon default and repossession of automobiles under consumer contracts, routinely apply for and receive insurance premium rebates. While the contract clause only refers to physical damage coverage, creditors regularly obtain rebates on all insurance financed including credit life and accident and health policies.

Thus from an economic or practical viewpoint the right to unearned insurance premiums is a substantial right. At either an individual level or looking to the aggregate amount of insurance financed, large sums of money are

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[17] Congressional concern over security interests was not limited to curbing abuses in connection with consumer loans secured by second mortgages on residences. Petitioner's Brief, at 11-14. Otherwise Congress need not have enacted 15 U.S.C. § 1637(a)(7), 15 U.S.C. § 1638(a)(10) and 15 U.S.C. § 1639(a)(8).

involved. Practically speaking the creditor's interest in unearned premiums affects consumer decisions about default on this or other credit obligations. Finally, the frequent use of the clause by creditors to claim unearned premiums signifies that it is a term essential to the relationship of the parties. In light of the above any characterization of the right to unearned insurance premiums as an "incidental and ephemeral right" ignores the reality of consumer credit transactions.

B. Disclosure Of The Security Interest In Unearned Insurance Premiums Need Not Result In Any Confusion To Consumers

It is within the control of those who draft retail installment contracts to determine how confusing those documents will be to consumers. Arguments for nondisclosure by the drafters based on avoiding consumer confusion must be received with some skepticism.

Professor Jeffrey Davis in his article, *Protecting Consumers From Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer Credit Contracts*, noted that the ability of a consumer to understand any item of information in a contract depends on three major characteristics of the document. They are information load, readability and conceptual difficulty.[18] This Court was quite correct in *Milhollin* when it stated that "meaningful disclosure does not mean more disclosure." [19] However, meaningful disclosure does not necessarily mean less disclosure.

Studies have demonstrated that the level of understanding increases as the information load increases, to

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[18] J. Davis, *Protecting Consumers From Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer Credit Contracts*, 63 U. Va. L. Rev. 841, 846-56 (1977) [hereinafter cited as J. Davis].

[19] *Milhollin*, 444 U.S. at 568.

an optimum level. Furthermore, each person's level of understanding peaks at approximately the same information load.[20] While it is a legitimate concern that the optimum information load is not exceeded, at least one study indicates that the "readability" of the information disclosed is more critical to understanding than the amount of information.

To test the significance of "readability", or the method of presentation, Professor Davis conducted empirical tests based on consumer contracts. He redrafted a typical retail installment contract, utilizing fewer, less complicated words. His test subjects understood the simplified contract 26% better than those subjects reading a typical contract. For example, 54.8% of the test subjects reading the *typical contract* understood the buyer's right to a rebate of interest charges upon repayment. Yet 80% of the test subjects reading the *simplified contract* understood that same right.[21]

Professor Davis then conducted another test. He drafted a contract deleting the excess disclosures but not altering the typical "legalese". He labelled it "less disclosure". He then drafted another contract which contained all of the disclosures, except it was drafted for "readability". The test subjects understood the "readable" contract much better than the "less disclosure" contract.[22] In that case less disclosure was in fact not better disclo-

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[20] J. Davis, at 848-49.

[21] J. Davis, at 876.

[22] The mean score on the "Less Disclosure" (LD) contract was 8.47. The mean score on the "Readable" (R) contract was 9.84. The probability that this difference is the result of random error was 0.01. Therefore the result was statistically significant. *See* J. Davis, at 869 n. 89.

sure. Simplification through redrafting was a much more effective aid to understanding. [23]

The contract clause in question is a good example of the importance of "readability." *Amicus* tested the reading level of the right to unearned premiums clause utilizing the Flesch formula.[24] Out of a score of 100, where 100 represents an extremely readable document, that clause scored 25.5.[25] The minimum score necessary to meet the Plain English Standard is 60. 25 scores at the low end of Difficult.[26] Stated another way, a score of 25 means that the contract clause tested at a college graduate reading level.[27] Even more telling is the contract

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[23] *Id.* at 887. That same group was also tested on the "Typical" and "Simplified" contracts. The score on the "Typical" contract was 7.74 and the score on the "Simplified" contract was 9.78. The closeness of the scores on the "Readable" and "Simplified" contracts is interesting. The "Readable" contract contained all the disclosures and was 630 words. The "Simplified" contract contained fewer disclosures and was 480 words. Again less is not necessarily better. *See* J. Davis, at 866, 886.

[24] R. Flesch, *How To Write Plain English* (1979). That formula measures readability according to sentence length and the number of syllables per word. Both have been shown to have predictive [illegible]e. *See* J. Davis, at 852.

[25] R. Flesch, *How To Write Plain English*, at 25. The Flesch test first appeared in R. Flesch, *A New Readability Yardstick*, 32 J. Applied Psych. 221 (1948).

[26] R. Flesch, *How To Write Plain English* at 26. This result is consistent with the "typical" contract used by Professor Davis. It also tested out at an above college graduate reading level on the Flesch formula. J. Davis, at 866.

[27] The contract clause used by Ford Motor Credit Company reads as follows:

> Buyer hereby assigns to Seller any monies payable under such insurance, by whomever obtained, including returned or unearned premiums, and Seller hereby is authorized on behalf of both Buyer and Seller to receive or collect same, to endorse checks or drafts in payment thereof, to cancel such insurance

clause used by one of the *Amici*, General Motors Acceptance Corporation. That paragraph is comprised of a single sentence, *273 words long*. It scored an amazing minus (-) 194 on the Flesch test.[28]

Professor Davis refers to the language typified by Petitioner's and Amici's contracts as "gobbledygook". If creditors were truly concerned with achieving meaning-

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or to release or settle any claim with respect thereto. The proceeds from such insurance, by whomever obtained, shall be applied toward replacement of the Property or payment of the indebtedness hereunder in the sole discretion of Seller.

[28] The contract clause used by General Motors Acceptance Corporation reads as follows:

(c) In the event that a charge for the required physical damage insurance protecting all interest hereunder is an item hereinabove included in the obligation payable under this contract or a charge for such insurance becomes included therein at any time hereafter under subparagraph (a) hereof, and in the further event that (1) the insurance company to which the seller is authorized to apply therefor refuses to issue such insurance, or (2) subsequent to issuance thereof and during the term of this contract such insurance is cancelled, then the seller shall apply either an amount equal to the aforesaid insurance charge in the case of (1) above, or in the case of (2) above an amount equal to the unearned portion of the premium for such insurance upon seller's receipt thereof from the insurer pursuant to authorization hereby given therefor, as a credit in reduction of that portion of the total of payments which comprises so much of one or more of the instalments payable on the latest due dates (including the final due date) hereunder as equals the amount herewith provided to be applied, it being understood and agreed that the order of applying said amount to said instalments shall be inverse to the order in which they are payable hereunder and that, in the further event that the seller procures insurance covering solely the interest of seller hereunder pursuant to the provisions next herein set forth in subparagraph (d), the amount to be credited and applied in the aforesaid events shall be reduced by an amount equal to the cost of such insurance covering solely the interest of the seller hereunder.

ful disclosure and promoting the informed use of credit, the first step *would not be* to delete significant disclosures. Redrafting for "readibility" would be the first priority. As Professor Davis discovered, the complicated and wordy consumer contracts can be successfully rewritten to contain all important disclosures and actually increase consumer understanding.

Accordingly, there need be no confusion of consumers by requiring the disclosure of the right to unearned insurance premiums. In fact by informing the consumer of an important contract term, the consumer's understanding of their relationship with the creditor will be enhanced.

CONCLUSION

The Third, Fifth, Seventh and Eighth Circuits have each presented well reasoned and logical arguments consistent with the purpose of TILA. The straightforward, two step approach advocated by those opinions is compelling.

15 U.S.C. § 1638(a)(10) requires disclosure of security interests. Regulation Z, 12 C.F.R. § 226.2(gg) defines a security interest as an interest in property that secures payment or performance of an obligation. Each of the circuits to consider the issue have found that right to unearned insurance premiums meets that definition of a security interest.

There is no exception in either the Act or the Regulations for "incidental" interests even if this was one. The Act allows the Federal Reserve Board to make an exception. It could have but failed to do so for security interests in unearned insurance premiums. In any event this security interest is not an incidental one. The right to $1,650.00 in unearned insurance premiums is a significant economic right to consumers with substantial practical consequences for the relationship between the parties.

Despite the current concern over information overload, that concern should play no role in deciding this issue. Studies show that the method used to present information is more important to consumer understanding than the number of contract terms. In light of those studies this Court should not underestimate the ability of consumers to understand contractual terms given proper, readable contracts.

Therefore, *Amicus* urges this Court to affirm the decision of the Seventh Circuit and find that the right to unearned insurance premiums and proceeds is a security interest that must be disclosed under TILA.

Respectfully Submitted,

MATTHEW J. MASON
RICHARD SCUPI
621 New Center Building
7430 Second Avenue
Detroit, MI 48202
(313) 872-4600

Attorneys for Amicus Curiae